

***United States Court of Appeals
for the Second Circuit***



**PETITIONER'S
BRIEF**

77-4047

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Nicholas Victor Findler)

and Catherine Findler,)

Petitioners)

v.)

Commissioner of Internal)

Revenue Service,)

Respondent)

Dkt. No. 77-4047

BRIEF FOR PETITIONERS

For the Petitioners:

Nicholas V. Findler

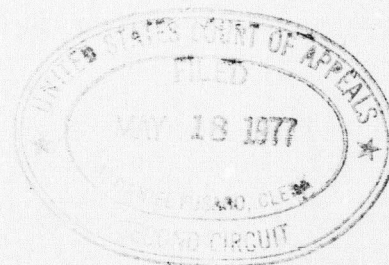
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|| The Petitioners waive their right for oral argument
and request that the Brief be taken on submission.



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(1) Statutes, Rules and Regulations

Internal Rev. Code, Section 117	3,4,5, <u>mult.</u>
Internal Rev. Code, Section 501(a), 501(c)(3)	5,24, <u>mult.</u>
Income Tax Regulations 1.117	3,4, <u>mult.</u>
Rev. Rul. 57-127, C.B. 1957-1	10
Rev. Rul. 58-222, 1958-1, C.B. 54	7,9, <u>mult.</u>
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(2) Cases of Precedence

Anderson v. US, Dist. Ct., 61-1 USTC 9162	9, 10
Chander P. Bhalla, 35 T.C. 13, 17; 1960	14, <u>mult.</u>
Bingler v. Johnson, 394 US 741, 751; 1969	16, <u>mult.</u>
Ethel M. Bonn, 34 T.C. 64	14, 17
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Clarence Peiss, 40T.C. 78, 1963	9,10,19, <u>mult.</u>
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George W. Stone, Jr., 23T.C.254	12,13, <u>mult.</u>
Louis C. Vaccaro, 58T.C.721, 1972, <u>acq.</u> 1973-1, C.B.2	10,11, <u>mult.</u>
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I. PRELIMINARY STATEMENT

It is respectfully requested of the United States Court of Appeals that the lack of legal knowledge and experience of the Petitioners be taken into consideration of the presentation of this case. Although the research performed by the Petitioners may have covered most of the relevant aspects, they cannot apply the appropriate terminology and the usual deductive methods in order to provide full support to their arguments.

Further, it is feared that certain additional disadvantages may arise due to the fact that the Petitioners waive their right for oral argument at the Court in view of the expenses involved in travelling to New York City. The Court is requested to consider also this factor.

II. STATEMENT OF CASE

(i) During the year 1972, Nicholas Victor FINDLER ('Petitioner' or 'grantee' in the following) received a fellowship from the National Science Foundation ('NSF' or 'grantor' in the following). The fellowship in question, \$5,640, was paid over a six-month period, June 27 - December 31. The grantee has excluded six times \$300 from his taxable income as the Internal Revenue Code allows it. The Internal Revenue Service ('Respondent' in the following) has contended the exclusion. The amount of tax under dispute is \$378.88. The United States Tax Court entered its decision for the Respondent.

(ii) The NSF is a non-profit making organization, in fact an agency of the United States Government. According to its charter, the objective of NSF is to promote scientific progress by supporting studies and research activities in a wide range of areas.

(iii) The grantor, NSF, had no role in selecting the problem the grantee was studying; it had no right to direct and control the manner in which the research was conducted or how much time was spent on it.

(iv) Neither the grantor nor its conduit, the Research Foundation of the State University of New York, nor the grantee's employer, the State University of New York at Buffalo, were rendered any direct service or economic benefit by the research conducted in the past nor will they do so in the future. The fellowship was, therefore, no compensation or payment for service.

(v) Over the period in question, the specified study and research were the Petitioner's only activity and at no time were teaching or administrative duties assigned to him. In fact, the period of six months coincided with his sabbatical year and he was not even on the premises of either NSF or the State University of New York at Buffalo.

Corollary:

All criteria and conditions of Section 117 of the Internal Revenue Code and Section 1.117 of the Income Tax Regulations are satisfied by the above facts; the present case falls directly within the letter, the spirit, and the intent of the above named Code and Regulation in regard to fellowships from which certain specified amounts of money can be excluded as taxable income.

* * *

It will be shown in Section IV that in a large number of cases, which are identical or similar to the present one, the Court has made decisions in favor of the taxpayer. It will be argued that the decision of the United States Tax Court, against which this Brief appeals, ignored both the legislative basis and the cases of precedence.

III. LEGISLATIVE BACKGROUND

The legislative purpose of Section 117 of the Internal Revenue Code, Scholarship and Fellowship Grants, was to enact a clear-cut method of distinguishing between taxable and non-taxable grants. (The latter had been considered and called gifts, in a less than distinct manner, prior to 1954.) The interpretations given to it by various Courts since that time have made the differentiation relatively easy to act upon -- in spite of some missing definitions in the original text.

Section 1.117-3(c) of the Income Tax Regulations provides:

A fellowship grant generally means an amount paid or allowed to, or for the benefit of, an individual to aid him in the pursuit of study or research. * * *

There are separate conditions for degree candidates and for people who are not degree candidates, and there are some general restrictions. These will be pointed out in connection with test cases. Whenever Courts have decided against taxpayers, one or more of the following conditions were not satisfied:

(i) The grantor was a profit-making organization whose direct or indirect interest was served in an economically tangible way by the grant, either at the time of the payment or, through some explicit commitments of the taxpayer, later on in the future.

(ii) The contractual arrangement entered by the grantee prescribed the type and/or the manner of delivery of some services that can be construed as a quid pro quo.

In a small number of cases, either more than \$300 per month or over a period longer than 36 (not necessarily consecutive) months were specified by the taxpayer. Since this issue is not contended by the Respondent, such situations will not be included in the argument below unless the case happens to contain this problem as well.

SEC. 117. SCHOLARSHIPS AND FELLOWSHIP GRANTS.

(a) **GENERAL RULE.**—In the case of an individual, gross income does not include—

(1) any amount received—

(A) as a scholarship at an educational institution (as defined in section 151 (e) (4)), or

(B) as a fellowship grant,

including the value of contributed services and accommodations; and

(2) any amount received to cover expenses for—

(A) travel,

(B) research,

(C) clerical help, or

(D) equipment,

which are incident to such a scholarship or to a fellowship grant, but only to the extent that the amount is so expended by the recipient.

Source: New.

[Sec. 117(b)]

(b) **LIMITATIONS.**—

(1) **INDIVIDUALS WHO ARE CANDIDATES FOR DEGREES.**—In the case of an individual who is a candidate for a degree at an educational institution (as defined in section 151 (e) (4)), subsection (a) shall not apply to that portion of any amount received which represents payment for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or the fellowship grant. If teaching, research, or other services are required of all candidates (whether or not recipients of scholarships or fellowship grants) for a particular degree as a condition to receiving such degree, such teaching, research, or other services shall not be regarded as part-time employment within the meaning of this paragraph.

(2) **INDIVIDUALS WHO ARE NOT CANDIDATES FOR DEGREES.**—In the case of an individual who is not a candidate for a degree at an educational institution (as defined in section 151 (e) (4)), subsection (a) shall apply only if the condition in subparagraph (A) is satisfied and then only within the limitations provided in subparagraph (B).

(A) **CONDITIONS FOR EXCLUSION.**—The grantor of the scholarship or fellowship grant is—

(i) an organization described in section 501(c)(3) which is exempt from tax under section 501(a),

(ii) a foreign government,

(iii) an international organization, or a binational or multinational educational and cultural foundation or commission created or continued pursuant to the Mutual Educational and Cultural Exchange Act of 1961, or

(iv) the United States, or an instrumentality or agency thereof, or a State, a territory, or a possession of the United States, or any political subdivision thereof, or the District of Columbia.

(B) EXTENT OF EXCLUSION.—The amount of the scholarship or fellowship grant excluded under subsection (a) (1) in any taxable year shall be limited to an amount equal to \$300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during such taxable year, except that no exclusion shall be allowed under subsection (a) after the recipient has been entitled to exclude under this section for a period of 36 months (whether or not consecutive) amounts received as a scholarship or fellowship grant while not a candidate for a degree at an educational institution (as defined in section 151 (c) (4)).

Source as originally enacted in the 1954 Code: New.

Amendments: Sec. as amended effective:
P. L. 87-256, § 110(a) 1-1-62

P. L. 87-256, § 110(a): Amended Code Sec. 117(b)(2)(A) to read as above. Prior to amendment, it read as follows:

"(A) Conditions for exclusion. — The grantor of the scholarship or fellowship

grant is an organization described in section 501(c)(3) which is exempt from tax under section 501(a), the United States, or an instrumentality or agency thereof, or a State, a Territory, or a possession of the United States, or any political subdivision thereof, or the District of Columbia."

Effective for taxable years beginning after 1961.

IV. ARGUMENTS BASED ON CASES OF PRECEDENCE

(A) Precedents Decided in Favor of the Taxpayer

In the following, direct quotations from court cases will be given, and the similarities and identities between these and the Petitioner's case will be pointed out.

(1)

26 CFR 1.117-1: Exclusion of amounts received
as a scholarship or fellowship grant.

Rev. Rul. 58-222

The amount received from a college by a member of its teaching staff (on sabbatical leave) while engaged in research in his particular field of interest does not constitute a scholarship or fellowship grant within the meaning of section 117 of the Internal Revenue Code of 1954. The amount so received is includible in the member's gross income as compensation.

The amount received by such member from a private (tax-exempt) foundation while engaged in such research is excludable from his gross income as a scholarship or fellowship grant to the extent provided by section 117 of the Code. Any amount received by him which is specifically designated to cover expenses for travel (including meals and lodging while traveling and an allowance for travel of his family), research, clerical help, or equipment incident to the scholarship or fellowship grant, is excludable from gross income to the extent that it is used for such purposes. Any unexpended portion of the amount received for such expenses is includible in his gross income.

Advice has been requested whether a taxpayer on sabbatical leave from a college where he is employed may exclude from Federal income tax the amount which he received from such college for use in research in the field of psychology and an amount received from a private foundation for the same use, as well as an amount allowed by the latter organization for travel expenses.

A member of the teaching staff of a college, who was on sabbatical leave, was awarded \$3,000 by such college to enable him to work out some theoretical ideas in psychology at a university within the United States, with an instructor who had a mutual interest. His activities were devoted to theoretical thinking and writing, and he had no teaching or administrative duties at the university. The college is not obligated to pay a staff member on leave; however, if the president of the college considers that a staff member has important theoretical or research problems on which to work, the college may award some financial support. The college exercised no control over the taxpayer's activities, and he was not obligated to make any reports or render any services to it.

The taxpayer also received from a private foundation, an educational and research organization exempt under section 501 (c) (3) of the Internal Revenue Code of 1954, a sum equivalent to the remainder of his normal yearly income, plus \$500 to cover the travel expenses of the taxpayer and his family from their home to the university.

Section 117(a) of the Code, relating to scholarships and fellowship grants, provides that, subject to certain conditions and limitations, amounts received under such grants are excludable from gross income. The exclusion extends to the value of contributed services and accommodations (such as room, board and laundry) which are received as part of the scholarship or fellowship grant. The exclusion also applies to amounts received to cover incidental expenses for travel, research, clerical help, or equipment incident to the scholarship or fellowship to the extent that they are expended by the recipient for these purposes.

If an individual is not a candidate for a degree, section 117(b) (2) of the Code provides, in part, that amounts received under such grants are exempt from taxation if "The grantor of the scholarship or fellowship grant is an organization described in section 501(c) (3) which is exempt from tax under section 501(a) * * *." The exclusion is limited to an amount equal to \$300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during such taxable year. No exclusion is allowable for a period of more than 36 months, whether or not consecutive.

In the instant case, the amount which the member of the staff received from the college where he is employed constitutes compensation for services rendered and is includible in his gross income by reason of the employer-employee relationship existing between him and the college. Accordingly, it is held that the amount received from the college by a member of its teaching staff (on sabbatical leave) while engaged in research in his particular field of interest does not constitute a scholarship or fellowship grant within the meaning of section 117 of the Code.

The amount received by such member from the private foundation while he was engaged in such research is excludable from his gross income as a scholarship or fellowship grant to the extent provided by section 117 of the Code. Any amount received by him which is specifically designated to cover expenses for travel (including meals and lodging while traveling and an allowance for travel of his family), research, clerical help, or equipment incident to the scholarship or fellowship grant, is excludable from gross income to the extent that it is used for such purposes. Any unexpended portion of the amount received for such expenses is includible in his gross income.

This situation is undeniably identical to the Petitioner's. He received, like the taxpayer in question, compensation (partial salary) from his university, which he has considered taxable. At the same time, the Petitioner received a fellowship from a not-for-profit foundation, like the taxpayer in question, the legally allowed part of which was excludable from his taxable income.

(2)-(8) In the following, copies of certain printed segments are inserted. These describe court cases that bear a direct relationship to the Petitioner's case.

Payments received for study or research activity are taxable if the activity primarily benefits the grantor. This restriction applies both to degree candidates and to those who are not. But if the activity primarily benefits the individual, the payments are not received for the grantor's benefit, although he might receive some incidental benefits from the end result.

A fellowship grant generally includes amounts paid or allowed an individual to aid him in the pursuit of study or research. There are, however, certain limitations on the amounts excludable.

¶ 6629 EXCLUSION FOR NON-DEGREE CANDIDATES

If an individual is *not* a candidate for a degree, two further limitations are: (1) the grantor must be a Sec. 501(c)(3) tax-exempt organization (educational, charitable, etc.), the U. S. government, a local government unit, a foreign government, or an organization under the Mutual Educational and Cultural Exchange Act of 1961; and (2) the amount excluded can not exceed \$300 times the number of months during the taxable year that the amounts are received—not exceeding a 36-month total (whether consecutive or non-consecutive), even though less than \$300 is received monthly (.05).

.05 Reg. § 1.117-2(b), 731 STANDARD FEDERAL TAX REPORTS ¶ 1177A, 1179.

This does not rule out the possibility of receiving additional nontaxable amounts from acceptable sources. A college teacher on sabbatical leave was allowed to exclude amounts received from a private tax-exempt foundation to the extent that they were used for his research. But amounts received from his employer while on leave were taxable. They came from the employer-employee relationship (.10).

.10 Rev. Rul. 58-222, 1958-1 CB 54.

Amounts received by United States citizens for study and research abroad under the Fulbright Act and the United States Information and Educational Exchange Act of 1948 qualify as scholarship or fellowship grants. But amounts received under these programs for teaching and lecturing abroad are considered compensation for services rendered.

The Tax Court has also recognized the possible dual role of an employee. A faculty member (not a candidate for a degree) of a medical school received a research grant from a foundation for study and research outside his faculty duties. The only condition was that he maintain full-time status on the faculty. In other words, he had two sources of income. The grant amounts were not taxable. The grant was made by a tax-exempt organization; its primary purpose was to further the taxpayer's education and research activity—not to benefit the grantor; and the amounts received were not a substitution for his teaching salary—they were supplementary to it (.80).

The application of the Regulations' requirement that the grantor cannot exercise direct supervision or control was illustrated where a taxpayer (a degree candidate) received amounts for clinical, teaching, and other services as an "assistant resident" at a Veterans hospital. There was evidence showing that each degree candidate needed a "residency" at some hospital (not necessarily a Veterans hospital) and had to investigate a specific problem as part of the degree requirements. While the hospital furnished the facilities used, the training program was under the actual supervision and guidance of the university. As a result, the payments received by the taxpayer for his residency activity were not included in his gross income (.85). In a similar case, the facts that progress reports were required and that the medical school received some incidental benefits from the resident's work did not alter the character of the payments as a fellowship grant (.90). However, a doctor who was a candidate for a M.S. degree in physical medicine was not allowed an exclusion for amounts received from a VA hospital as a resident under a "career resident" contract which called for future service after completion of his residency (.92).

.80 *Clarence Peiss* (1963), 40 TC 78, CCH Dec. 26,007.

.85 *Anderson v. U. S.*, U. S. Dist. Court, Dist. of Minnesota, 61-1 USTC ¶ 9112.

.90 *Pappas v. U. S.* (1967), U. S. Dist. Court, Dist. of Arkansas, 67-1 USTC ¶ 9386.

.92 *John E. and Nancy K. Quast v. United States*, U. S. Ct. of Appeals, Eighth Circuit, aff'g U. S. Dist. Court, 70-2 USTC ¶ 9478, 428 F. 2d 750; 69-1 USTC ¶ 9114, 293 F. Supp. 56.

However, amounts paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research are considered to be amounts received as a scholarship or fellowship grant for the purpose of section 117 if the primary purpose of the studies or research is to further the education and training of the recipient in his individual capacity and the amount provided by the grantor for such purpose does not represent compensation or payment for the services described in subparagraph (1) of this paragraph. Neither the fact that the recipient is required to furnish reports of his progress to the grantor, nor the fact that the results of his studies or research may be of some incidental benefit to the grantor shall, of itself, be considered to destroy the essential character of such amount as a scholarship or fellowship grant.

(Also Section 3402; 31.3402(a)-1.)

Rev. Rul. 60-130

Grants for Scholars in Cancer Research made by the American Cancer Society through certain institutions as administrators, which are paid to specified individuals to aid them to acquire independent experience in cancer research beyond that usually obtained through postdoctoral training, constitute fellowship grants which are excludable from the recipients' gross incomes to the extent provided by section 117(b)(2) of the Internal Revenue Code of 1954. Furthermore, since the recipients render no services to or for the benefit of the grantor or the institutions administering the grants, such amounts do not constitute wages subject to the withholding of income tax under section 3402 of the Code.

Revenue Ruling 57-127, C.B. 1957-1, 275, distinguished.

(9) Another important ruling of the Court on which the Petitioner wishes to rely is the case of Louis C. Vaccaro, 58 T.C. 721 (1972), acq., 1973-1 C.B. 2. The taxpayer in question spent his sabbatical year at another university doing studying, research and editing a book. It seems important to quote verbatim the opinion of the Court:

trial, counsel for the respondent placed heavy emphasis on the fact that Vaccaro competed with other applicants for the fellowship appointment. It was further pointed out that topics of proposed research projects were an important consideration in the final selection of the six postdoctoral fellows. We find both points to have no better than a neutral effect on our decision. Scholarship and fellowship grants can be the subject of competition much like employment. Both the prospective employer and the educator have a right to invest their money, whether as wages or academic grants, in the best talent available. Furthermore, the nature of the payments is not changed merely because the university screened the applicants' research topics. It appears to us that the procedure was most probably designed to make certain that people with similar professional interests were given access to the money.

The bookkeeping procedures employed by the university to make the stipend payments to petitioner, plus consideration of the ultimate source of fellowship funds, present strong circumstantial evidence that petitioner was a university employee. Nevertheless, we find this evidence deceiving. Normal fellowship disbursement procedures could not have been used to make the HEW funds available to petitioner because of the very requirements written into the cost reimbursement contract between the U.S. Office of Education and the University of Oregon. Therefore, to make some of the money available for petitioner's stipend he had to be listed on the school's payroll as a research associate.⁶ The University of Oregon, however, was the grantor of the funds for purposes of section 117, *Marjorie E. Haley*, 54 T.C. 642 (1970), and because its personnel may have been using earmarked funds for non-authorized purposes does not change the substance of the fellowship arrangement, which was to provide funds to postdoctoral fellows while they studied and improved their research skills.

The withholding of taxes from the recipients' payments has been held to be indicative of employee status, *Jerry S. Turem*, 54 T.C. 1494 (1970),⁷ as has a requirement that the recipient file periodic progress reports on his work, *Howard Littman*, 42 T.C. 503 (1964). In petitioner's case, the inferences are not valid for there was a reason for each of the procedures. Both the withholding tax and the progress reports were formalistic measures required under the HEW contract to make the funds available for Vaccaro. Furthermore, withholding Federal income tax from the checks was appropriate since petitioner's stipend exceeded the allowable section 117 exclusion of \$300 per month. Finally, the Commissioner's own regulations, section 1.117-4, Income Tax Regs., state that because a recipient must file progress reports with the grantor or because the grantor may gain incidental benefits from his work, does not change the essential character of the grant if it is primarily for the recipients' benefit.

Likewise, we find that petitioner's right to full faculty privileges does not, of itself, make him a university employee. It is not extraordinary that petitioner received these gratuities as part of his fellowship. Certainly, with his education he was a professional peer of the university faculty and because CASEA wanted to attract highly qualified individuals to participate in the fellowship program it seems logical that it would make its benefits as generous as possible. Moreover, allowing petitioner to participate in university group life and

medical care plans or counting his fellowship term for purposes of longevity placed no additional financial burden on the university.

We are not persuaded by respondent's attempts to make petitioner's case analogous to the facts in *Howard Littman, supra*. The distinguishing factor in *Littman* is that there the grantor was unquestionably paying for the taxpayer's services. Had the taxpayer not been present, the grantor would have been forced to hire an employee to perform his duties. In the instant case, the benefits of petitioner's work were for the whole national academic community and not just the University of Oregon. Petitioner's absence from the program would not have necessitated the assumption of his work by other university personnel.

Decision will be entered for the petitioners.

(10) The case of George Winchester Stone, Jr., Professor of English at George Washington University (23 T.C. 254) should also be noted. He received, on a competitive basis and because of his prior scholastic accomplishments, a fellowship from the Guggenheim Foundation, a not-for-profit entity. It was awarded for a project of the grantee's own selection, working on it with methods of his own devising.

The committee of selection chooses among the applicants for fellowships seeking to assist the ablest people who apply in any year. Awards are based upon the applicants' present abilities to do creative work or advanced research in the fields of their particular interests as revealed by their past achievements.

The grants are made primarily to assist scholars and creative artists to carry on their own works of research and artistic creation.

The taxpayer received the fellowship during his sabbatical year when he also earned his half-salary from his regular employer, the George Washington University. The opinion of the Court says:

The respondent argues that the award was paid as compensation for services to be rendered by the petitioner, saying that it was granted on the basis of the petitioner's qualifications to do the work required by his project, which project was approved by the foundation with the expectation of results consistent with the petitioner's qualifications, and that to the extent there is any donative intent in making the award the beneficiary is society at large and not the petitioner whose services were expected in return for the grant. It is pointed out that the application showed the potential value of the results of the project to future scholars and historians, and that the amount of the award

was in approximately the amount of the salary loss to the petitioner in taking sabbatical leave. It is argued that the purpose of the foundation is to promote the advancement of knowledge and to add to the literary and scientific power of the country and that the fulfillment of this purpose depends upon the selection of projects from which results can be expected, and hence it is not unreasonable to conclude that the foundation adopts as its own the projects proposed by the fellows it selects.

This argument misconceives the motives of both the petitioner and the foundation. The foundation does not accomplish its purposes by employing scholars or scientists to carry out projects.

Since the foundation is a corporation exempt from income tax, it cannot give away money indiscriminately, but must exercise some selectivity in choosing the recipients of its aid. Accordingly, it asks for a statement of the work proposed to be done by each applicant and it investigates his qualifications and capabilities. The secretary of the foundation testified that the objective is to choose the most meritorious individuals, those who can best advance their training or creative achievements, rather than the projects considered most beneficial to the public. The emphasis, he said, was upon individuals, not projects. In providing funds to qualified persons to carry out their own projects of creative work or self-advancement the foundation is carrying out the desires of its founders to give others educational opportunities such as their son would have had if he had lived. Here it made a gift to aid a worthy scholar that he might accomplish more readily a self-imposed task which would add to his professional standing. As an incidental result of the research the petitioner has since been able to give graduate seminars in 18th century English drama.

The petitioner, on his part, did not offer his services to the foundation to do research under its direction upon a subject selected by it, nor was he seeking to sell or realize upon the prospective result of his labors.

The grant was in the nature of a scholarship to facilitate the further education or training of the recipient even though in this case he held several degrees. His research was in a field of his own selection. He was under no obligation to perform services for the foundation or any other person. The arrangement between the foundation and the fellow is not an employment contract. The foundation does not assume or stipulate for authority to direct and control the fellow as to the details and means by which the project is carried out, to require conformity with a schedule of working hours, to supervise the work to see that it is satisfactorily done, or to require reports on the progress of or the completion of the task. The payments are not for services.

(11) In the case of Evans (34 T.C. 720; 1965-1, Cum. Bull. 4; Rev. Rul. 65-146; 1965-1, Cum. Bull. 66), the Court decided also against the Commissioner of the Internal Revenue Service. The petitioner

received a stipend "...paid primarily to aid and encourage petitioner in furtherance of her education..." In distinction, the Court quoted an earlier case:

In *Ethel M. Bonn*, 34 T.C. 64, we held that amounts received by a graduate physician from the Veterans' Administration while serving as a resident in psychiatry at a Veterans' Administration hospital constituted compensation for services rendered and were not excludible from income under section 117. But there we found that the resident-trainee program was merely incidental to the "*raison d'être* of the Hospital, namely, the care of its patients" and that the resident trainees concurrently performed valuable professional services of a substantial nature essential to the operation of the hospital and that the payments were compensation for those services. That case is clearly distinguishable from this case on the facts.

(12) With reference to a merely nominal statement in the present Petitioner's grant from the NSF concerning the Foundation's use of some potential products of the research supported, the very relevant case of Chander P. Bhalla (35 T.C. 13, 17; 1960) is quoted:

In 1956, the National Science Foundation which is a Federal agency of the Department of Health, Education, and Welfare, made a grant of \$19,700 to the University of Tennessee for support during a period of approximately 2 years, of research in "Multiple Meson Production in Energetic Collisions of Nucleons." Such research was in the field of pure, rather than applied, physics; and there was practically no possibility of any patents resulting therefrom.

The university charged petitioner's stipend against the grant which it had received from the National Science Foundation. Also, it withheld income tax from the stipends of petitioner, and reported the same to the Internal Revenue Service on Form W-2.

We attach no significance to the fact that the University of Tennessee made withholdings of income tax with respect to the stipend. The evidence indicates that the university attempted, without conclusive result, to determine how the stipend should be treated for income tax purposes; and in such situation, it may well have acted with an abundance of caution, in order to safeguard itself against possible charges or penalties for failure to perform its duty in a field where the law was not clearly defined. Such exercise of caution could do no harm to petitioner for, if the withholdings were erroneous, suitable adjustment could be claimed by petitioner on his return, as was actually done. See to the same effect *George L. Stone*, 32 T.C. 1021.

We decide the present issue in favor of the petitioner.

Decision will be entered for the petitioner.

(13) Another case, Wells (40 T.C. 40), goes even further in recognizing the purpose of such fellowships:

Because the payments to petitioner come from a governmental source, the argument is made that they must be compensatory and hence includable in income. After emphasizing the provisions of the statute under which petitioner received her payment,⁶ respondent contrasts it with another section of the law which he presumably regards as primarily educational in purpose without apparently recognizing that this is as much an "employment" provision as the other.⁷

And, again, relying on a broad and general regulation,⁸ he proceeds to the conclusion that if any services are rendered which are "subject to the direction or supervision of the grantor," the payment cannot be a scholarship, thereby, and contrary to express statutory provision, neatly eliminating all university research fellowships which are conducted under university direction and supervision.

Respondent's argument does an injustice to his own regulations. The portion cited is applicable to all situations and not merely to those in which a candidate for a degree is performing required services. But the language of section 117 and its legislative history⁹ make it clear that amounts received as a scholarship or fellowship grant may be compensatory in character and may still be excludable from income. See *Chander P. Bhalla, supra*. Respondent's regulations, viewed in their entirety, reflect this. The regulation cited by respondent, in order to give meaning to it in its context and not to be in contravention of the statutory purpose, must be read as referring to an amount received primarily for the purpose of rendering services or performing supervised activities as contrasted with furthering the education and training of the recipient in his individual capacity. Cf. *Frank Thomas Bachmura, supra*. We think petitioner has brought herself clearly within the factual dimensions of the primary purpose test.

Decision will be entered for the petitioner.

⁶ 72 Stat. 1247 (1958), 38 U.S.C., sec. 4114(a).

"The Administrator, upon the recommendation of the Chief Medical Director, may employ, without regard to the Classification Act of 1949, physicians, dentists, and nurses, on a temporary full-time, part-time, or fee basis; and dietitians, social workers, librarians, and such other professional, clerical, technical, and unskilled personnel * * * on a temporary full-time or part-time basis at such rates of pay as he may prescribe. * * *"

⁷ 72 Stat. 1248 (1958), 38 U.S.C., sec. 4114(b).

"The Administrator shall have authority to establish residencies and internships; to appoint qualified persons to such positions without regard to civil-service or classification laws, rules, or regulations; and to prescribe the conditions of such employment, including necessary training, and the customary amount and terms of pay during the period of such employment and training." (Emphasis added.)

⁸ Sec. 1.117-4(c), Income Tax Regs.

⁹ H. Rept. No. 1337, *supra* at pp. 17, A37.

S. Rept. No. 1622, to accompany H.R. 8300 (Pub. L. 591), 83d Cong., 2d Sess., pp. 17, 188 (1954).

(B) Precedents Decided in Favor of the Internal Revenue Service

For the sake of completeness and objectivity, it is necessary to list those cases in which the decision was entered for the Respondent. The essential and material differences between these and the Petitioner's case will be pointed out.

(1) Bingler vs. Johnson (394 U.S. 741, 1969)

There were several fundamental differences between this case and the Petitioner's. The grantor was a profit-making company, the Westinghouse corporation. Further, the contract for the grant stated: "(The taxpayer) is obligated ... (on the completion of his leave) to return to Westinghouse for at least two years."

The above can hardly be considered a "no-string" research grant. The Court held that the taxpayer was pursuing studies primarily for the benefit of the grantor, a service was to be rendered in the future for the company, and that the policy of providing a study grant by the company served as an attraction to staff being recruited.

Similar was the case in Woodail vs. Commissioner (321 F. 2d 721, C.A. 10-th Circuit) when a resident physician was obligated by the grant contract to remain with the same employer after his part-time participation in a training program supported by the employer.

None of the above characteristics exist in the Petitioner's case.

(2) Ethel M. Bonn (34 T.C. 64, 1960)

This is a most illuminating example. In fact, on page 13 of this Brief, with reference to the case of Evans (supra), the opinion of the Court was quoted in regard to this case. It is of importance to make a fuller quotation at this time:

Petitioner relies principally upon *George Winchester Stone, Jr.*, 23 T.C. 254, and *Wroblewski v. Bingler*, (W.D. Pa.) 161 F. Supp. 901. Both cases are readily distinguishable on their facts.

In the *Stone* case the taxpayer received a grant from the Guggenheim Foundation, an organization formed "to promote the advancement and diffusion of knowledge and understanding and the appreciation of beauty, by aiding * * * scholars, scientists and artists * * * in the prosecution of their labors." Fellowships had been granted in 60 different fields of study, with no economic benefit derived by the grantor. Typically a grant would be made to permit the recipient to carry on his chosen projects, using his own work methods.

Stone had received a grant to assist him in carrying on a project selected by him, embracing certain research and data respecting 18th century English dramatic performances. The grantor exercised no supervision, made no suggestions, received no economic benefit.

In the instant proceeding the VA not only determined what type of work petitioner was to do, but retained and exercised control and supervision at all times over the method of its performance, including the length and number of workdays per week. She was subject to reassignment not only within the Hospital, but to other institutions as well. And, finally, her activities resulted in substantial economic benefit to the grantor, since she performed valuable professional services of a nature essential to the carrying out by the Hospital of its principal purpose, the care and treatment of patients.

In *Wroblewski* the taxpayer, a physician, received a stipend from the University of Pittsburgh as a participating graduate physician in its training program at the Western State Psychiatric Institute and Clinic.

It was found as an ultimate fact that the taxpayer was not primarily performing services for the Institute or University. The grant was accordingly afforded the benefits of section 117.

Here the Hospital was organized and operated for the care and treatment of patients, who were admitted solely on the basis of veteran status and actual need for hospitalization. The value or worthlessness of any given case to the training of residents or advancement of science was a matter of total indifference insofar as admissions were concerned. The adoption of a resident trainee program and the appointment of persons such as petitioner to residencies were merely incidental to and for the purpose of facilitating the *raison d'être* of the Hospital, namely, the care of its patients.

Thus, the case at bar presents a picture diametrically opposed to that in *Wroblewski*, where the institution existed for training purposes, and the admission of patients was merely incidental to and based primarily on the needs of the training program, rather than those of the patient.

Whatever the value to petitioner of any training and experience received by her, and whatever her aims and purposes in accepting the position, she in fact performed valuable services and received the amount in question as compensation therefor. Respondent's determination must be sustained.

(3) Robert W. Carroll (60 T.C. 96, 1973)

This case was adjudged in favor of the Commissioner for the sole reason that the taxpayer had been engaged 1/3 of his time on the same project on the premises of his university during the academic year. During the summer months, he was supposed to spend full-time efforts also at the university. Therefore, no distinction could be made between his activity during the academic year and the summer months. The other characteristics of his research noted in the Court proceedings were not relevant for the decision, as can be seen from the precedents referred to above. The present Petitioner's situation was different in that regard, too.

(4) Marjorie E. Haley (54 T.C. 642, 1970)

It is worth quoting again in this instance:

Under the educational leave grant agreement signed by the petitioner in 1963, she agreed, in accepting the grant from the State Commission, to work at least 1 year in a county welfare department in the State of Oregon or in the State Commission following the period of training. She also agreed to accept employment where the need for work was greatest and to refund training grant payments if she either failed to complete the period of study or failed to carry out the employment agreement.

Under the educational leave grant agreement signed by the petitioner in 1964 she agreed, for and in consideration of the grant, to accept a position assigned by the State Commission in public welfare within the State Commission or a county public welfare de-

partment and to discharge the duties of the assigned position for a period of at least twice the length of time of the educational leave. She agreed to reimburse the State Commission for the amount paid on the grant if she failed to accept the position assigned by the State Commission, or if she failed satisfactorily to discharge in its entirety the employment commitment. As petitioner received 9 monthly payments, she was obligated under the 1964 agreement to work for the State Commission or a county department for 18 months. The 1964 reimbursement provision varied from the 1963 contract by providing for a prorata repayment based on actual months of employment.

. It is obvious that the above type contract eliminates the essential "no-string" requirement in the Internal Revenue Code.

(5) Clarence Peiss (40 T.C. 78, 1963; acq., 1968-2, C.B. 2)

This is a case in clear analogy with that of the present Petitioner's. The opinion of the Court was quoted on page 9 of this Brief. and is given in more detail herebelow:

Section 117, *supra*, does not contain any definition of a fellowship grant but respondent in his regulations (sec. 1.117-3(c), Income Tax Regs.), has stated: "A fellowship grant generally means an amount paid or allowed to, or for the benefit of, an individual to aid him in the pursuit of study or research." The grant here falls well within respondent's general definition of a fellowship grant. The essence of respondent's argument is that the award from the Markle Foundation constituted compensation and was substitution for salary from the school. Petitioner's teaching obligations at the school were a minor part of his work. He spent about 25 percent of his time in fulfilling his teaching obligations. During the balance of the time he was free to engage in research activities in projects of his own choosing. He would receive the grant if he performed no research. He had to remain a faculty member in order to receive the grant but the university had no requirement that faculty members pursue research.

The grant here was not compensation for services to be performed. It was much like the Guggenheim grant in *George Winchester Stone, Jr., supra*, and there we held the award was not paid to the grantee as compensation for services. Under respondent's regulation, if grants do not represent payment for services and are designed to enable the recipient "to pursue studies or research [they] are considered to be amounts received as a scholarship or fellowship grant for the purpose of section 117 if the primary purpose of the studies or research is to further the education and training of the recipient in his individual capacity * * *." Sec. 1.117-4(c)(2), Income Tax Regs. Here it clearly appears the primary purpose of the grant was to further the education and research activities of the Markle scholar.

(6) Aloysius J. Proskey (51 T.C. 918, 1969)

The facts of the case indicate the following:

As part of the duties of his residency during 1965, petitioner was directly responsible for making diagnoses and prescribing treatment for patients.

A handbook issued to residents and interns shows that their duties included recording the history and physical examinations of each patient seen, promptly after the patient's admission; writing a progress note at least weekly on each patient's record; posting of elective surgery; obtaining written consent for surgery; completing the death notice for all patients who died; obtaining permission for autopsy; notifying the local medical examiner in the case of a body dead on arrival; reporting all diseases listed by the Michigan Department of Health; and dictating a case summary (or discharge letter) promptly after discharge of each patient. Although petitioner served as a teaching associate in the medical school, he did not establish that he was exempt from these duties assigned to residents and interns generally. In view of these multitudinous activities, subject as they were to the constant direction and control of University Hospital, petitioner was not free to pursue studies or research of his choice. See *Howard Littman*, 42 T.C. 503, 509-510 (1964); cf. *George Winchester Stone, Jr.*, 23 T.C. 254 (1954).

Petitioner received a stipend during 1965 from University Hospital as compensation for employment services. He had received stipends similar in character for more than 36 months prior to the beginning of that year.

None of the above conditions existed in the present Petitioner's case.

(7) Marjorie Schwartz (28 CCH Tax Ct. Mem. 762, 1969)

In this case, the Court has found that "(The) Petitioner's study was undertaken at the request of and primarily for the benefit of her employer."

These conditions do not exist in the present Petitioner's case.

(8) Robert W. Willie (57 T.C. 383, 1971)

The taxpayer's employer ("Municipal") and not the grantor, the Department of Health, Education and Welfare, was responsible for the selection of the grantee and for the grantee's duties in the supported program. The Court held that

Although HEW's grant to Municipal may well have been disinterested and noncompensatory in nature, Municipal's grant to petitioner was quite different. The payments were made in return for petitioner's services and are therefore fully includable in his gross income. *Jerry S. Turem, supra* at 1506; *Majorie E. Haley*, 54 T.C. 642, 647 (1970); *Frederick Fisher*, 56 T.C. 1201 (1971).

More important however, the participating personnel, including petitioner, were not on an educational leave status, but were still teaching while being paid additional amounts to participate in the program on a per diem basis of remuneration.

This case is materially different from the Petitioner's, too.

(9) Beulah M. Woodfin (31 CCH Tax Ct. Mem. 208, 1972)

The Court held that the petitioner was working under "...tight direction and supervision, with a service to perform..." Further, "...she was not free to engage in research activities of her own choosing." "(She had a) regularity of working hours." Finally, the Court states that "...although the NSF's grant to the university may well have been non-compensatory in nature, the University's payments to the petitioner (as a Research Associate; present Petitioner's addition) were quite different."

The above situation is fundamentally different from this Petitioner's.

(C) Arguments Concerning the Decision of the United States Tax Court on the Petitioner's Case, T.C. Memo. 1976-352

Finally, the Petitioner would like to reflect on the opinion and decision of the United States Tax Court expressed in T.C. Memo. 1976-352. It is contended that the Court has completely ignored the argument of the Petitioner, based on a significant amount of research, and made the blanket statement: "...none of the cases cited by either party deal with facts comparable to those here present." (line 12 to 14, page 15) The case of Robert W. Carroll, 60 T.C. 96 (1973) was singled out. This Brief has discussed that case on page 18 and explained the difference between the two.

In its findings, the Tax Court claims that "...it is not even shown by this record that the [Petitioner's] education was enhanced by the research he did in 1972." (line -6, page 19). It is the Petitioner's view that such argument, besides being unfounded, is not relevant and supportive of the Court's opinion.

The Petitioner agrees that the grantor wanted the study and research to be performed and considered the Petitioner an appropriate individual to do so. These facts, however, are not material as in the Louis C. Vaccaro case (supra), the Court stated: "...Scholarship and fellowship grants can be the subject of competition much like employment....Topics of proposed research project were an important consideration in the final selection of the [candidates]."

The Petitioner further contends that the Court's reference "... the NSF funds were for the services he performed on the research project..." is unfounded and immaterial. The Court stated in the case of Pappas (supra) that indirect and "incidental benefits"...did not alter the character of the payments as a fellowship grant." In the Vaccaro case (supra), almost the same words are used and the Court quotes the Commissioner's own regulations, Section 1.117-4, in contradicting the Respondent. Further, in the almost identical cases of George W. Stone, Jr. and of Clarence Peiss (supra), the Tax Court also recognizes that the taxpayer's study and research were not for the benefit of the grantor and that thereby no services were rendered.

With regard to the fact that the "...Petitioner continued to be covered by the employee benefit programs of the university during the (line -6, page 20), 6-month period..."^X the Petitioner again quotes the Court's opinion in the Vaccaro case (supra): "...Moreover, allowing the petitioner to participate in university group life and medical care plans or counting his fellowship term for purposes of longevity placed no additional burden on the university...."

V. CONCLUSIONS

The legislative background and the arguments based on cases of precedence, as presented in the previous two Sections, lead to the conclusions that

(i) The National Science Foundation is an agency of the United States Government and qualifies as a disinterested grantor of no-string fellowships under Internal Revenue Code Section 501(c)(3).

(ii) The area and subject matter of the research pursued by the Petitioner were of his own choosing and contributed to his education and research experience.

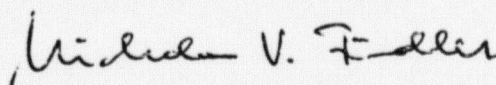
(iii) No economic or other direct benefit was obtained either by the grantor or its conduit, the Research Foundation of the State University of New York.

(iv) No teaching or administrative duties and responsibilities were assigned to the Petitioner during the time period in question.

(v) The research work done represents no service rendered in the past or in the future.

The Court of Appeals is hereby requested to consider all the above arguments and conclusions, reverse the decision of the U.S. Tax Court, and entitle the Petitioner to exclude from his fellowship income \$1,800 for the year 1972 and declare the tax deficiency of \$378.88 void.

Respectfully submitted,



Nicholas V. Findler

May 15, 1977.